This record is a partial extract of the original cable. The full text of the original cable is not available.

181300Z Jan 05

UNCLAS SECTION 01 OF 02 ANKARA 000310

SIPDIS

SENSITIVE

TREASURY FOR INTERNATIONAL AFFAIRS - MMILLS AND RADKINS

E.O. 12958: N/A
TAGS: EFIN TU
SUBJECT: REFORM DELAYS PUSH BACK TIMING OF IMF LETTER OF INTENT, BOARD VOTE

¶1. (SBU) Summary: With the completion of the required "prior actions" likely to take several more weeks, the IMF board vote on Turkey's new Stand-by Program is unlikely to take place before March. The delays seem to stem more from the complexity of the reforms, or internal Turkish issues than from lack of ownership or disagreement with the IMF. With markets calm and no immediate GOT financing need, the delay is not that serious, but, if the delay persists Turkey runs the risk of spooking markets, particularly if there are other, unexpected market-unfriendly developments. End Summary.

Turkish Treasury Official Describes State of Play with IMF:

¶2. (SBU) Despite the joint IMF-GOT announcement December 14 that the two sides had reached broad agreement on a new program, the GOT was required to take tangible steps on three major reforms before a Letter of Intent could be signed. The IMF required that three major legislative reforms either be passed by the Council of Ministers and submitted to Parliament (Social Security and Banking) or passed by Parliament (Tax Administration). Ozgur Demirkol, the Department Head in Turkish Treasury charged with coordinating the IMF negotiations, briefed econoffs January 13 on the state of play for each reform.

Tax Administration Reform:

¶3. (SBU) The Tax Administration Reform needs to be passed by Parliament, since the IMF has been seeking this reform since well before discussions began on a new program last summer. The IMF has agreed with the GOT on the main features of the new law for some time. Demirkol confirmed press reports that there continue to be disagreements within the Turkish bureaucracy about turf issues. Much as the privileges of the Sworn Bank Auditors became central to negotiations over the Banking Law (see below), in the case of the Tax Administration, the tax inspectors are fighting to retain their separate status from the Tax Administration. Demirkol pointed out that Finance Minister Unakitan is himself a former tax inspector. In any case, Demirkol was optimistic that the law would go to the Prime Minister very soon, such that it can be approved by Council of Ministers and submitted to Parliament.

Banking Law:

¶4. (SBU) The Banking Law, which had been a bone of contention between the Bank Regulatory and Supervisory Agency (BRSA) and the IFI's, has reportedly now been submitted to the Prime Minister's office by Deputy Prime Minister Sener. Demirkol believes that the two features most objected to by the IMF and World Bank have been modified by the Government, overruling the BRSA. The BRSA-drafted version had called for Sworn Bank Auditors to retain their monopoly of on-site inspection, ignoring the recommendations of the independent commission that investigated the Imar Bank collapse. The other issue, according to Demirkol, was that the BRSA draft required undercapitalized banks to be intervened and then liquidated. He said the IMF wanted regulators to have more flexibility to give banks a few months to try to take corrective action, so as to spare the state the unnecessary expense of a liquidation, if possible. Despite these fixes by the government, which should be sufficient to satisfy the IFI's, Demirkol noted that the general restrictiveness and prescriptiveness of the BRSA's approach to the law remains.

Social Security Reform:

¶5. (SBU) The Social Security Reform is probably the most politically sensitive and revolutionary of the three reforms. Though the World Bank and Social Security Institution (SSK) disagreed about assumptions in the projections used to formulate pension options for consideration by the Prime

Minister, Social Security officials told econoffs this issue has been resolved. The disagreement caused a delay, however, in the technocrats' planned presentation to the Prime Minister, causing a window of opportunity to be missed. Separately, Social Security Director Tuncay Teksoz explained that three key targets have been agreed with the IMF: the total Social Security Deficit will be not surpass the current 4.5% of GNP level in the short run, savings of 1% of GNP will be achieved by 2015, and in 20 to 30 years the deficit will brought down to only 1% of GNP. Demirkol and one World Bank official said that the IFI's leave the GOT to decide which options to use to achieve the savings, so long as the overall targets are met (and the assumptions used are conservative).

¶6. (SBU) The Social Security Reform has also been held up by delays over GOT consultation with labor unions. A meeting planned for the same day Parliament considered the controversial law transferring Health Ministry hospitals to the SSK was boycotted by the unions in protest. Teksoz told us they needed to have a meeting with social partners and factor in their comments before the law could be officially submitted to the Prime Minister's office. Meanwhile, he said that the Prime Ministry was reviewing the laws (there are four of them) on an unofficial basis. Though the Social Security Reform is expected to harm the interests of the public sector unions, Teksoz did not expect great political difficulty with the reform. The grandfathering of existing accrued pension rights, the unfairness of the current system with its multiple regimes, the long phase-in period for changes, and the adoption of universal heath insurance should help the GOT sell the reform to the public, in his view.

Other IMF issues:

¶7. (SBU) Demirkol confirmed local IMF officials' comments to us that they could accept the lower (8% rather than 18%) VAT rate on food, education and health services. Demirkol explained that not all food items were covered, and that some of the items with the lower rate--such as the ubiquitous bagel-like "simits" sold on every street corner--are largely in the untaxed informal economy any way. For this reason, Demirkol asserted there would be very little tax revenue lost from the lower rate.

¶8. (SBU) Demirkol and a local World Bank official also shrugged their shoulders over the Prime Minister's announcement of reduced interest rates on state bank loans to farmers and small business. They said the relatively modest amount of money was transparently budgeted for, and was not in violation of any understanding with the IFI's. The World Bank official surmised that the Prime Minister was under pressure to carry through on his promise of a "surprise" but was constrained from repeating last-year's yearend populist surprise minimum wage and pension payment increases.

Rumored Reorganization of Economic Ministries:

¶9. (SBU) The Turkish press is reporting that Minister Babacan will be named EU negotiator, while Treasury and the Ministry of Finance will be merged under Minister Unakitan. Demirkol confided that higher-level colleagues were hinting the reports were accurate. Treasury staff are now worried that the distinct, pro-reform Treasury culture could be subsumed into the more traditional civil servant culture of the Ministry of Finance.

Comment:

¶10. (SBU) The local IMF representative shares our take that the delays do not seem to be related to lack of GOT ownership of the reforms. However, both the Resrep and Demirkol agreed that if they drag on too much further markets could get jittery, particularly if there are other negative developments. Moreover, rumors of a government reorganization could have the effect of tending to postpone tough decisions, if the economic ministries really are going to be reorganized.
EDELMAN